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American Council for Capital Formation

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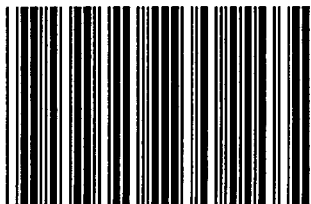
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SPEECH BY SENATOR MAX BAUCUS
AMERICAN COUNCIL FOR CAPITAL FORMATION
SEPTEMBER 4, 1986

INTRODUCTION

IT'S AN HONOR TO BE A PART OF THIS CONFERENCE, ESPECIALLY AS A MEMBER OF THIS PANEL.

ONE REASON IS THAT I HAVE SO MUCH RESPECT FOR GARY. HE'S ONE OF THE FINEST TRADE AND TAX EXPERTS IN THE COUNTRY.

THE OTHER REASON IS THE IMPORTANCE OF THIS PARTICULAR PANEL.

WE AMERICANS WILL
FOR THE REST OF THIS CENTURY, ~~WE~~ BE STRUGGLING TO IMPROVE OUR INTERNATIONAL COMPETITIVENESS. IN TIME, THIS STRUGGLE WILL DRIVE MOST PUBLIC POLICY DECISIONS, WHETHER ABOUT EDUCATION POLICY, LABOR POLICY, OR TAX POLICY.

AND HELP
THIS PANEL'S DISCUSSION WILL SET THE STAGE FOR MANY MORE TO COME.

SLOW

INTERNATIONAL COMPETITIVENESS

VAT PROPONENTS HAVE ALWAYS ARGUED THAT A VAT WILL ENHANCE AMERICA'S INTERNATIONAL COMPETITIVENESS.

IN THE PAST, THIS ARGUMENT WASN'T TAKEN SERIOUSLY. INTERNATIONAL COMPETITIVENESS DIDN'T SEEM VERY IMPORTANT.

AFTER ALL, WHEN CONGRESS PASSED THE 1954 TAX CODE, ^{WE} AMERICANS PRODUCED 60% OF THE WORLD'S GNP AND OWNED 26 OF THE WORLD'S TOP 30 CORPORATIONS.

WE LED THE PACK, AND COULD AFFORD ^{TO} MAKE TAX POLICY DECISIONS AS IF WE EXISTED IN SPLENDID ISOLATION FROM THE REST OF THE WORLD.

EVEN IN 1977, WHEN AL ULLMAN PROPOSED HIS INFAMOUS TAX RESTRUCTURING ACT, THE UNIFIED TRADE ACCOUNT SHOWED AN \$8 BILLION SURPLUS.

~~WELL, THE WORLD ISN'T CHANGING. IT'S~~
~~CHANGED.~~

THAT WAS 1977!

Today, HOWEVER,

INSTEAD OF PRODUCING 60% OF THE WORLD'S GNP,
WE PRODUCE 26%.

INSTEAD OF OWNING 26 OF THE TOP 30 CORPORATIONS, WE OWN 15.

AND INSTEAD OF HAVING A TRADE SURPLUS, WE HAVE A \$170 BILLION DEFICIT. EXPORTS HAVE FALLEN, AND WE IMPORT 50% OF OUR STEEL, 33% OF OUR LUMBER, 31% OF OUR TEXTILES, AND 30% OF OUR CARS.

THESE AREN'T JUST ABSTRACT STATISTICS.

THEY TRANSLATE INTO LOST JOBS AND A LOWER STANDARD OF LIVING.

FOR EXAMPLE,

THE MEDIAN INCOME OF THE AVERAGE AMERICAN FAMILY IS NOW THE SAME AS IT WAS IN 1965.

THE DAYS OF SPLENDID ISOLATION ARE OVER. WE CAN NO LONGER AFFORD TO TAKE AMERICAN ECONOMIC SUPERIORITY FOR GRANTED.

AS A RESULT, WE HAVE TO MAKE MANY CHANGES.

WHAT ARE THOSE CHANGES.

ELIMINATING UNFAIR FOREIGN TRADING PRACTICES AND STABILIZING THE VALUE OF THE DOLLAR ARE VITALLY IMPORTANT.

THAT ~~DAW~~ ROSTENCOWSKY HARVEY BALE

BUT THE PROBLEM RUNS MUCH DEEPER THAN THAT.

SINCE 1960, U.S. PRODUCTIVITY HAS GROWN AT AN ANNUAL RATE OF 2.7 PERCENT. BRITAIN'S HAS GROWN AT A RATE OF 3.6 PERCENT. JAPAN'S HAS GROWN AT A WHOPPING 8 PERCENT. EVERY MAJOR FOREIGN COMPETITOR HAS INCREASED ITS PRODUCTIVITY FASTER THAN WE HAVE. EVERY ONE!

UNLESS WE REVERSE THIS TREND, ALL THE TRADE LAWS IN THE WORLD WON'T MAINTAIN OUR COMPETITIVE EDGE OR OUR RELATIVE STANDARD OF LIVING.

IN THE END, WE HAVE TO PRODUCE OUR WAY OUT OF THE TRADE DEFICIT BY IMPROVING THE "INPUTS" INTO OUR ECONOMY--^{LOWER} ~~THE~~ COST OF CAPITAL, ^{BETTER} EDUCATION AND ^{MORE CREATIVE} TRAINING, AND MANAGEMENT SKILLS.

THE VAT AND COMPETITIVENESS

THE TAX SYSTEM PLAYS AN IMPORTANT ROLE. IT AFFECTS VIRTUALLY EVERY ASPECT OF THE ECONOMY.

AND IT HAS A PARTICULARLY IMPORTANT EFFECT ON THE COST OF CAPITAL.

AS TECHNOLOGY IMPROVES, LABOR COSTS BECOME A SMALLER PROPORTION OF TOTAL COSTS, AND THE COST OF CAPITAL BECOMES A MORE IMPORTANT FACTOR IN INTERNATIONAL COMPETITION.

AT THIS POINT, OUR COST OF CAPITAL IS TWICE AS HIGH AS JAPAN'S AND SIGNIFICANTLY HIGHER THAN ANY OF OUR MAJOR COMPETITORS'. THE TAX REFORM ^{UNFORTUNATELY} BILL MAY DRIVE IT EVEN HIGHER.

IF WE WANT A TAX SYSTEM THAT'S DESIGNED FOR INTERNATIONAL COMPETITION, WE NEED TO ADDRESS THIS PROBLEM.

GARY'S PAPER EXPLAINS HOW THIS CAN BE DONE.

IT'S AN EXCELLENT ANALYSIS, AND I AGREE
WITH HIS CONCLUSIONS.

IN THE LONG RUN, THE CORPORATE INCOME TAX IS
A SALES TAX IN DISGUISE. ✓

BY REPLACING THE CORPORATE INCOME TAX WITH A
VALUE ADDED TAX, WE CAN IMPROVE OUR INTERNATIONAL
COMPETITIVENESS.

WE COULD IMPOSE THE TAX ON IMPORTS AND REBATE
IT ON EXPORTS, WITHOUT RUNNING AFOUL OF THE GATT
TAX SUBSIDY PROVISIONS. SOME ECONOMISTS ARGUE
THAT EXCHANGE RATE ADJUSTMENTS WOULD OFFSET THIS
EFFECT, BUT I DON'T HAVE MUCH FAITH IN EXCHANGE
RATE THEORIES THESE DAYS. IF RECENT FLUCTUATIONS ARE
ANY GUIDE.

IN ADDITION, GARY SHOWS THAT REPLACING THE
CORPORATE TAX WITH A 4% VAT WOULD INCREASE COR-
PORATE PROFITS, INCREASE PERSONAL SAVINGS, AND
REDUCE THE COST OF CAPITAL. OVERALL, THAT WOULD
STIMULATE AS MUCH AS \$50 BILLION A YEAR WORTH OF
NEW INVESTMENT.

AND,

ALTHOUGH GARY CAUTIONS OTHERWISE,

WE ALSO SHOULD CONSIDER IMPOSING A VAT TO
REDUCE THE BUDGET DEFICIT, AS ~~LESTER THURLOW HAS~~
~~SUGGESTED.~~

IS NOT THE SOLE CAUSE, BUT IT

THE BUDGET DEFICIT ^A IS AN IMPORTANT CAUSE OF
OUR TRADE DEFICIT. IT OFFSETS ALL OF THE PERSONAL
SAVINGS IN THIS COUNTRY, FORCING US TO RELY EXCES-
SIVELY ON FOREIGN CAPITAL.

~~AT THIS POINT IN THE BUDGET PROCESS, THE EASY~~
~~SPENDING CUTS AND REVENUE BASE BROADENERS HAVE~~
~~ALREADY BEEN ENACTED.~~

FUNDAMENTALLY, A VAT WILL BOTH THE ^{HAVE}
PRACTICAL EFFECTS AND THE PSYCHOLOGICAL
FROM THE PERSPECTIVE OF INTERNATIONAL COM- ^{EFFECTS TO}
PETITIVENESS, A VAT MAY BE PREFERABLE TO CONTINUED ^{HELP MAKE US}
BUDGET DEFICITS. ~~THIS DESERVES FURTHER STUDY.~~ ^{MORE}
COMPETITIVE.

THE POLITICAL DIMENSION

IN CASE ANY OF YOU THINK THAT I'M PREDICTING
THAT CONGRESS WILL ENACT A VAT IN THE NEAR FUTURE,
~~YOU'RE WRONG.~~ YOU'RE WELL ADVISED TO
GUESS AGAIN.

AT THIS POINT, THE CONGRESS OF THE UNITED STATES IS NO MORE LIKELY TO REPLACE THE CORPORATE INCOME TAX WITH A VALUE ADDED TAX THAN THE NEXT SESSION OF THE MONTANA LEGISLATURE IS TO OUTLAW FLY FISHING.

AS AN INSTITUTION, CONGRESS TENDS NOT TO LEAD, BUT TO FOLLOW THE MOOD OF THE AMERICAN PEOPLE. AND THE AMERICAN PEOPLE AREN'T IN THE MOOD FOR A NATIONAL CONSUMPTION TAX.

CONSUMERS AREN'T LIKELY TO SUPPORT A TAX ON CONSUMPTION JUST BECAUSE IT WILL INCREASE CORPORATE PROFITS ^{OR LOWER CAPITAL COSTS.} THEY'RE SUSPICIOUS THAT THOSE PROFITS WILL BE FRITTERED AWAY ON TINKER-TOY MERGERS RATHER THAN PLOWED BACK INTO NEW EQUIPMENT AND BETTER JOBS. THEY SAW WHAT HAPPENED AFTER ERTA. AND THEY KNOW THAT THE DECLINE IN CORPORATE ~~income~~ TAXES HAS NOT BEEN ACCOMPANIED BY AN INCREASE IN U.S. COMPETITIVENESS.

^{THIS YEARS}
~~THE~~ TAX REFORM DEBATE DEMONSTRATED THIS IN SPADES. THE ONE ARGUMENT THAT WAS CONSISTENTLY WELL RECEIVED WAS THE ARGUMENT THAT WE SHOULD RAISE CORPORATE TAXES.

GIVEN SUCH SKEPTICISM, WE CAN ONLY PERSUADE THE AMERICAN PEOPLE TO SUPPORT A VAT IF WE PERSUADE THEM THAT THEIR STANDARD OF LIVING WILL RISE.

AND THAT KIND OF PERSUADING WILL REQUIRE AMERICAN BUSINESS LEADERS TO DEMONSTRATE THAT THEY CAN LOOK BEYOND SHORT-TERM PROFIT MARGINS AND COME UP WITH CREATIVE SOLUTIONS TO ~~REDUCE COSTS~~ DRAMATICALLY ~~MEANS~~ IMPROVE PRODUCTIVITY AND PROVIDE WELL PAYING JOBS.

CONCLUSION

THAT'S NO EASY TASK.

AND IT WON'T HAPPEN OVERNIGHT.

BUT WE'RE NOT RUNNING A 100-YARD DASH. WE'RE RUNNING A MARATHON. WE'VE GOTTEN OFF TO A SLOW START, BUT THERE'S PLENTY OF TIME TO ESTABLISH A STEADY, WINNING PACE.

THERE IS GOOD EVIDENCE THAT A VAT WILL IMPROVE OUR INTERNATIONAL COMPETITIVENESS. BUT IT

WILL TAKE TIME TO CONVINCE THE AMERICAN PEOPLE
THAT IMPROVING OUR INTERNATIONAL COMPETITIVENESS
MEANS IMPROVING ~~OUR STANDARD OF LIVING~~ ^{ALL THE COMPONENTS THAT AFFECT} AND IT
WILL TAKE TIME TO REFINE OUR ANALYSIS OF THE VAT
AND JUST HOW IT SHOULD WORK.

PRODUCTIVITY
INCLUDING
TAX POLICY.

PROFESSOR HUFBAUER'S PAPER IS AN IMPORTANT
CONTRIBUTION TO BOTH OF THESE EFFORTS. THANK YOU
FOR THE OPPORTUNITY TO PARTICIPATE TODAY.